Supreme Court, U.S.
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No.

In The

Supreme Court of the United States

October Term, 1997

PAUL J. ENGELHART, *et al.*,

Petitioners,

vs.

CONSOLIDATED RAIL CORPORATION, *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether Consolidated Rail Corporation ("Conrail") violated the anti-inurement provision of the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. § 1103(c)(1) when Conrail used that part of the surplus assets of the Supplemental Pension Plan of Consolidated Rail Corporation ("Supplemental Plan") attributable to employee contributions to fund a special early retirement program ("SVP") and retiree health care account.

2. Whether Conrail violated the exclusive benefit rule of ERISA, 29 U.S.C. § 1104(a)(1) when it used that part of the surplus assets of the Supplemental Plan attributable to employee contributions to fund the SVP and retiree health care account.

PARTIES TO THE PROCEEDING

In addition to the parties appearing in the caption of the case, the following persons are petitioners:

William J. McIlfatrick
H.C. Kohout
Carl C. Brandt
Lawrence Cirillo
Charles D. Nester
Thomas F. Meehan, Jr.
Jacqueline A. Mace
Donald E. Kraft
Robert E. Graham

In addition to the parties appearing in the caption of the case, the following persons are respondents:

Supplemental Pension Plan of Consolidated Rail Corporation; and

Pension Administration Committee of the Supplemental Pension Plan of Consolidated Rail Corporation.

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Paul J. Engelhart, *et al.*, respectfully petition for a writ of certiorari to review the judgment of the United States Court Appeals for the Third Circuit in this case.

OPINIONS BELOW

The judgment of the court of appeals, App., *infra*, 1a-2a, is not reported. The order of the court of appeals denying rehearing, App., *infra*, 18a-19a, is unreported. The memorandum and order of the District Court, App., *infra*, 3a-17a, dismissing the petitioners' claims to an interest in the surplus assets of the Supplemental Plan is unreported.

STATEMENT OF JURISDICTION

The court of appeals entered its judgment on August 5, 1997, App., *infra*, 1a-2a. A timely petition for rehearing was denied on August 29, 1997 (App., *infra*, 18a-19a), and a petition for a writ of certiorari is accordingly due on November 27, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(a).

STATUTORY PROVISIONS INVOLVED

The statutory provisions involved in this case, 29 U.S.C. § 1103(c)(1) and 29 U.S.C. § 1104(a)(1) are set forth in pertinent part in the Appendix, *infra*, at 20a.

STATEMENT OF THE CASE

This class action case involves two attempts — each successful in the court below — by Consolidated Rail Corporation ("Conrail") to use the surplus assets of the Supplemental Pension Plan of Consolidated Rail Corporation ("Supplemental Plan"), an overfunded, contributory, defined

benefit pension plan to underwrite the cost of a special early retirement program ("SVP") and to pay certain retiree health care expenses for Conrail employees and retirees eligible to participate in the SVP. The petitioners are all former long term railroad industry employees who are currently receiving pension benefits from the Supplemental Plan, and who made matching mandatory employee contributions to pension plans maintained by their various employers who were the railroad industry ancestors of Conrail. The petitioners challenged Conrail's use of that part of the Supplemental Plan surplus derived from employee contributions to fund these benefits as violations of the anti-inurement provision of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1103(c)(1) and the exclusive benefit provision of ERISA at 29 U.S.C. § 1104(a)(1). The District Court dismissed these claims pursuant to Federal Rule of Civil Procedure 12(b)(6) after concluding that the petitioners had no specific pre-termination rights in the surplus assets of the Supplemental Plan under *Van Orman v. American Insurance Co.*, 680 F.2d 301, 313 (3rd Cir. 1982). In both instances the Third Circuit erroneously affirmed the decision of the District Court thereby permitting Conrail to use the surplus assets of the Supplemental Plan without regard to the rights of the participants in that surplus attributable to their contributions. Both issues warrant further review.

A. The Fiduciary Standards Of ERISA.

The fiduciary standards established in Title I of the Employee Retirement Income Security Act of 1974, Pub. L. No. 94-406, 88 Stat. 832 ("ERISA") are an essential ingredient of a comprehensive statutory scheme designed to protect the expectations of pension plan participants regarding their retirement benefits. ERISA established a lattice of sometimes overlapping fiduciary duties which are imposed upon those who act as fiduciaries with respect to "employee welfare benefit

plans" and "employee pension benefit plans" or "pension plans" as those terms are defined at 29 U.S.C. § 1102(1) and (2). Generally, ERISA at 29 U.S.C. § 1102(21)(A) states that a person is a fiduciary with respect to an employee welfare benefit plan or a pension plan to the extent that he or she exercises any discretionary authority or control over the management of a plan, the disposition of its assets or over plan administration. Under this standard, fiduciary status can attach to corporate directors, employees and plan sponsors who administer a plan. *Leigh v. Engle*, 727 F.2d 113, 133-134 (7th Cir. 1984); *Phillips v. Amoco Oil Co.*, 799 F.2d 1464, 1471 (11th Cir. 1986), *cert. denied*, 493 U.S. 919 (1987); and *United States v. Grizzle*, 933 F.2d 943 (11th Cir.), *cert. denied*, 112 S. Ct. 271 (1991).

Under its network of fiduciary duty provisions at 29 U.S.C. §§ 1103-1104 and the prohibited transaction rules at 29 U.S.C. § 1106, ERISA establishes a high standard of conduct — the "highest known to law" — for fiduciaries of employee pension plans. Serota, *ERISA Fiduciary Law*, at 19, Bureau of National Affairs (1995), quoting *Donovan v. Bierwirth*, 680 F.2d 263, 272 n.8 (2nd Cir.), *cert. denied*, 459 U.S. 1069 (1982). The specific statutory duties at issue in this case are keystones of this web of fiduciary protection. ERISA's anti-inurement rule at 29 U.S.C. § 1103(c)(1) states

> the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purpose of providing benefits to participants in the plan and their beneficiaries. . . .

App., *infra*, 20a. The exclusive benefit rule of ERISA at 29 U.S.C. § 1104(a)(1)(A) imposes a duty upon a plan fiduciary to discharge his or her duties with respect to a plan solely in the interest of its participants and beneficiaries and ". . . for the exclusive purpose of: (i) providing benefits to participants and

their beneficiaries; and . . .". App., *infra*, 20a. With the exception of the prohibited transaction rules at 29 U.S.C. § 1106, ERISA does not explicitly define what conduct may result in a violation of the anti-inurement and exclusive benefit provisions. That task has been left to courts to determine by applying the common law of trusts as directed by this Court in *Varity Corporation v. Howe*, 516 U.S. 489, 116 S. Ct. 1065, 134 L. Ed. 2d 130 (1996).

B. The Factual Background.

1. The History Of The Supplemental Plan.

The petitioners are former long-term employees of the railroad industry in the northeastern United States. Each began his, or her, employment with the Pennsylvania Railroad Company ("PRR") during the period between 1936 and 1956. C.A. App. A574-A579.[1] The petitioners continued working for the PRR though its ill-fated 1968 merger with the New York Central Railroad Company ("NYC") and their evolution into the Penn Central Transportation Company ("Penn Central"). Petitioner Engelhart, for example, worked for the PRR from September 16, 1948 until the February 1, 1968 NYC merger. Thereafter he worked for Penn Central until its 1976 acquisition by Conrail. He retired from Conrail on August 31, 1988 after 40 years of continuous service in the railroad industry.

Increasing competition for freight and passenger traffic and declining revenues drove the Penn Central and many of its smaller railroad counterparts into bankruptcy in the 1970s. C.A. App. A577. Effective January 1, 1976, Consolidated Rail Corporation ("Conrail") was created by Congress in the Regional Rail Reorganization Act of 1973, as amended, 45 U.S.C. § 701, *et seq.* to acquire the rail properties of many of these bankrupt

1. We refer to the appendix below in *Engelhart v. Consolidated Rail Corporation*, No. 96-1920.

railroads ("the Merged Railroads", collectively) including the Penn Central. C.A. App. A579. Conrail's railroad operations were heavily subsidized by the United States government in the period between January 1, 1976 and March 26, 1987. On the latter date the United States government, pursuant to the Conrail Privatization Act, as amended, 45 U.S.C. § 1301, *et seq.* sold 85% of the newly issued common stock of Conrail in a public offering on March 26, 1987. The remaining 15% of Conrail's common stock was distributed to approximately 90,000 current and former Conrail employees or their beneficiaries in October and November, 1987. C.A. App. A579. After March 26, 1987 Conrail's stock was publicly traded on the New York Stock Exchange.

The Supplemental Plan is a pension plan that was established by Conrail to provide retirement benefits for its eligible employees and those former employees of the Merged Railroads. C.A. App. A579. The Supplemental Plan is administered by the Pension Administration Committee ("PAC"), whose members are Conrail employees designated to serve as the Supplemental Plan "administrator" as that term is defined by ERISA at 29 U.S.C. § 1002. Each of the petitioners is currently receiving pension benefits from the Supplemental Plan, and is therefore a participant therein as that term is defined by ERISA at 29 U.S.C. § 1002(7).[2] Many of the Merged Railroads maintained contributory defined benefit pension plans (the "Merged Plans") for the benefit of their eligible employees. In

2. The term, "participant", is defined as

> . . . any employee or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer or members of such organization, or whose beneficiaries may be eligible to receive any such benefit.

particular, the Penn Central maintained a contributory pension plan known as the Plan for Supplemental Pension, Penn Central Transportation Company, of February 1, 1968, as amended to January 1, 1976 (plan established June 1, 1938 by Pennsylvania Railroad Company) (including employees of the Chicago River and Indiana Railroad Company and the Cleveland Union Terminals Company) (The "Penn Central Plan"). C.A. App. A581. The Penn Central Plan like many of the Merged Plans was funded by matching employer and employee contributions. C.A. App. A582, A587. This pattern of matching employer and employee contributions had been carried forward from the contributory defined benefit pension plan sponsored by the PRR and known as the "Plan for Supplemental Pensions for Employees of the Pennsylvania Railroad" ("PRR Plan"). Both agreement, *i.e.*, union, and non-agreement, *i.e.*, management employees, participate in the Supplemental Plan and participated in the Penn Central Plan and the PRR Plan. C.A. App. A587.[3] Each of the petitioners had been a participant in the PRR Plan and one, or more, of the Merged Plans to which they and their various railroad employers contributed equally. C.A. App. A582.[4]

When the Merged Plans were merged into the Supplemental Plan, the assets and liabilities of those plans were transferred to the Supplemental Plan. Following the absorption of the Merged Plans into the Supplemental Plan, Conrail made employer

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3. Mandatory matching contributions by PRR non-agreement employees to the PRR Plan were discontinued effective February 1, 1965. Thereafter, neither the Penn Central Plan nor the Supplemental Plan required matching contributions by non-union personnel. C.A. App. A587.

4. The petitioners, Engelhart, McIlfatrick, Kohout, Meehan, and Nester were former PRR non-agreement employees who were not obligated to make matching contributions after February 1, 1965. The remaining petitioners, Brandt, Cirillo, Mace, Kraft and Graham, were required to make contributions as agreement employees until their retirements. Agreement employees are still obligated to contribute to the Supplemental Plan. C.A. App. A574-A579, A707.

contributions to the Supplemental Plan from 1976 until 1984 when it determined that such employer contributions were no longer actuarially required. C.A. App. A589. These circumstances were reflective of the growth of the assets held in the Supplemental Plan from $276,000,000 in 1976 to $832,816,000 in 1990. Meanwhile, the number of participants in the Supplemental Plan had dwindled from almost 50,000 in 1976 to 18,599 in 1990. C.A. App. A590. Conrail has made no employer contributions to the Supplemental Plan since 1984 when it was a corporation wholly owned and subsidized by the United States government. C.A. App. A589.

Meanwhile, the Supplemental Plan surplus, *i.e.*, the amount by which the value of plan assets exceeded anticipated benefit liabilities, soared from $118,457,098 in 1982 to $394,000,000 in 1991. This surplus in the Supplemental Plan was attributable to (i) mandatory contributions by Merged Railroad employees; (ii) mandatory contributions by Conrail agreement employees; (iii) forfeitures of non-vested benefits by terminated Merged Railroad and Conrail employees; (iv) employer contributions by the Merged Railroads; (v) employer contributions by Conrail while it was subsidized by the United States government, and (vi) favorable investment experience. C.A. App. A587-A588.

2. The Diversion Of The Supplemental Plan Surplus.

On March 26, 1990 Conrail amended the Supplemental Plan, effective December 13, 1989, to create a Special Voluntary Pension ("SVP") which provided an enhanced early retirement package for those Conrail non-agreement employees who had attained age 55 and 5 years of service, who elected to retire on, or before, alternative special voluntary retirement dates of January 31 or February 28, 1990, and who were not then receiving benefits from the Supplemental Plan. C.A. App. A592-A593. The early retirement package provided retirement benefits

equal to 1% of the employee's average compensation during the last 3 years of Conrail employment multiplied by the actual number of years of Conrail service increased by 5. The SVP benefits formula, unlike the formulas for normal retirement and standard early retirement benefits, were not reduced by an offset based upon the employee's Railroad Retirement Act benefits or any early retirement age reduction factors.[5] C.A. App. A593. This formula greatly enhanced the retirement benefits for SVP recipients over those typically available at normal or early retirement. In addition, those Conrail employees who elected to participate in the SVP program and who were under age 62 received a special monthly retirement supplemental of $900 until age 62, or could elect to receive immediately an actuarially equivalent lump sum. C.A. App. A593. The initial cost of funding this SVP program was estimated at $109,000,000 and was paid entirely from the surplus assets of the Supplemental Plan to the approximately 700 participating Conrail employees. C.A. App. A593.

Prior to January 1, 1992 Conrail had provided health care benefits for certain retired Conrail non-agreement employees. The cost of providing these benefits was paid directly by Conrail. C.A. App. A594. Effective January 1, 1992, Conrail established a retiree health benefits account under Internal Revenue Code § 401(h) at 26 U.S.C. § 401(h) to discharge its obligations to those retired management personnel participating in the Consolidated Rail Corporation Non-Agreement Retirees' Medical Benefit Plan ("Retirees' Medical Plan"). C.A. App. A827. The health benefits account was funded from the surplus assets of the Supplemental Plan. C.A. App. A594.

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5. Railroad Retirement Act benefits are the railroad industry equivalent of Social Security Act retirement benefits. *Eichel v. New York Central Railroad Company*, 375 U.S. 253, 11 L. Ed. 2d 307, 84 S. Ct. 316 (1963).

Generally, § 401(h) of the Internal Revenue Code allows a pension plan to provide for the payment of health benefits for retired employees, their spouses and dependents. The Internal Revenue Code at 26 U.S.C. § 420 allows the surplus assets of an overfunded pension plan to be used to fund a retiree health benefit account established under 26 U.S.C. § 401(h) if the transfer is a qualified transfer within 26 U.S.C. § 401(b).[6] Acting in reliance upon 26 U.S.C. § 401(h), Conrail transferred $4,100,000 from the Supplemental Plan surplus to fund the retiree health benefits accounts for the Retirees' Medical Plan year ending April 30, 1991. C.A. App. A594. A second transfer of $6,500,000 was made for the year ending April 30, 1992, and Conrail announced its intentions to continue making these annual transfers through the year ending April 30, 1996. C.A. App. A594-A595.

C. Proceedings Below.

1. The petitioners filed this action in the United States District Court for the Eastern District of Pennsylvania ("the District Court") on December 9, 1992. C.A. App. A571-A829. Jurisdiction rested on 28 U.S.C. §§ 1331, 2201-2202 and 29 U.S.C. § 1132(e)(1). The petitioners presented individual and class action claims challenging the use by Conrail of that portion of the surplus assets of the Supplemental Plan attributable to

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6. The Revenue Reconciliation Act of 1990 (P.L. 101-508) introduced Internal Revenue Code § 420. Prior to that legislation, the transfer of surplus pension assets to fund retiree health benefits accounts would have been an impermissible reversion to the employer thereby triggering the imposition of excise tax under 26 U.S.C. § 4980 and possibly under 26 U.S.C. §§ 4975(c)(1)(D) and (e)(2). 26 U.S.C. § 420 provides a safe harbor for such employers. Significantly, such a transfer of surplus assets is permissible if in addition to satisfying the safe harbor requirements of § 420, the transfer contravenes no other law. *See* 26 U.S.C. § 420(b)(1)(B).

employee contributions to fund the SVP program and the retiree health benefits account.[7] C.A. App. A571-A604.

In their complaint the petitioners alleged that Conrail's use of the Supplemental Plan surplus to fund these two new categories of benefits violated (i) the anti-inurement provision of ERISA at 29 U.S.C. § 1103(c)(1) and the exclusive benefit rule of ERISA at 29 U.S.C. § 1104(a)(1). C.A. App. A595-A596, A599-A604. Conrail took the position that its actions in amending the Supplemental Plan to create these new categories of benefits were not subject to ERISA's fiduciary standards. App., *infra*, 5a.[8] Thereupon, Conrail moved to dismiss the relevant counts of the complaint pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure. App., *infra*, 5a.

The District Court, relying upon *Van Orman v. American Insurance Co.*, 680 F.2d 301, 313 (3rd Cir. 1982), held that the petitioners had no specific pre-termination rights in the Supplemental Plan surplus except those which may arise under ERISA's fiduciary duty provisions. App., *infra*, 6a. In analyzing those fiduciary duties the District Court determined that

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7. The petitioners raised other claims as well with respect to (i) the payment of certain administration expenses from the assets of the Supplemental Plan; (ii) the method of estimating the Railroad Retirement Act benefit used to calculate the pension offset for management employees; (iii) the application of age reduction factors to certain disability and early retirement benefits. The petitioners do not seek certiorari with respect to those claims.

8. The petitioners named Conrail, the Supplemental Plan, PAC and Mellon Bank, N.A., the trustee of the Supplemental Plan, as defendants. Mellon Bank was dismissed from the action by stipulation of the parties after the District Court's disposition of the respondents' motion to dismiss under Rule 12(b)(6) of the Federal Rules of Civil Procedure. Unless the context indicates otherwise, the respondents shall be referred to collectively as "Conrail".

Conrail's actions in amending the Supplemental Plan were plan design or business decisions which did not implicate, nor warrant review, under the fiduciary duty provisions of ERISA. App., *infra*, 7a-8a. The District Court relied upon *Hozier v. Midwest Fasteners, Inc.*, 908 F.2d 1155, 1158 (3rd Cir. 1990) and held that the incidental benefit to Conrail by so amending the Supplemental Plan did not result in the violation of any fiduciary duties to the petitioners. App., *infra*, 7a-8a. Further, the District Court concluded that the creation of the retiree health benefits account was exempt from the fiduciary duty provisions of ERISA because the funding of such an account was specifically authorized by the Internal Revenue Code at 26 U.S.C. § 420. App., *infra*, 8a-9a. Based upon this analysis, the District Court dismissed the petitioners' claims as to the use of the Supplemental Plan surplus to fund the SVP program and the retiree health benefits account. App., *infra*, 9a.[9]

2. The Third Circuit affirmed the District Court without an opinion and entered judgment against the petitioners on August 5, 1997. App., *infra*, 1a-2a. The petition for rehearing and suggestion for rehearing en banc, was denied by the Third Circuit on August 29, 1997. App., *infra*, 18a-19a.

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9. The District Court entered its order of dismissal on August 16, 1993. App., *infra*, 3a. The petitioners had presented these claims on behalf of themselves and the Engelhart Class. On November 15, 1993 the District Court approved the parties' stipulation as to the certification of the Engelhart Class under Rule 23(b)(2) of the Federal Rules of Civil Procedure with respect to the claims which survived the motion to dismiss. Those claims are not germane to this petition.

REASONS FOR GRANTING THE WRIT

This case presents the issue of whether participants in an overfunded contributory defined benefit pension plan have any rights in the surplus assets of the plan prior to its termination.[10] The petitioners do not disagree with the principle that the employer may create new categories of benefits and fund those benefits from the surplus assets attributable to employer contributions. However, the petitioners assert that such benefits may not be funded from that portion of the surplus assets attributable to employee contributions.

The court below failed to grasp this critical distinction between the portions of the surplus attributable to employer and employee contributions. The continued incursions by Conrail through its funding of new benefits from the Supplemental Plan surplus will, if such inroads continue unabated, jeopardize the financial security protecting the pensions payable to the petitioners and other participants and their beneficiaries.

The issues presented in this appeal have divided the courts of appeal and are of exceptional importance. Certiorari is clearly warranted.

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10. Participants in an overfunded contributory plan clearly have rights in the surplus assets of the plan at its termination. *See* ERISA at 29 U.S.C. § 1344(d). Participants of a contributory plan are entitled to a pro rata share of the residual assets of a terminating plan before there can be any reversion of surplus assets to the employer plan sponsor.

I.

THE COURT SHOULD RESOLVE THE CONFLICT IN THE CIRCUITS OVER WHETHER THE PARTICIPANTS IN AN OVERFUNDED, CONTRIBUTORY PENSION PLAN HAVE PRE-TERMINATION RIGHTS IN THE PLAN SURPLUS UNDER THE FIDUCIARY STANDARDS OF ERISA.

The Third Circuit — following the Seventh Circuit, but in conflict with the Ninth Circuit — erroneously held that the petitioners have no rights in the surplus assets of the Supplemental Plan under ERISA's fiduciary provisions prior to the termination of the plan. The Third Circuit correctly focused upon whether ERISA's fiduciary duty provisions attached to Conrail's amendments of the Supplemental Plan to fund the SVP program and retiree health benefits from the plan's surplus assets. However, the Third Circuit failed to first consider whether the body of law interpreting ERISA's fiduciary duty provisions created any rights for the petitioners in that portion of the plan surplus attributable to their employee contributions. This Court should grant certiorari to resolve the conflict among the circuits on this important issue of federal law.

A. The Decision Below Squarely Conflicts With The Decision Of The Ninth Circuit.

1. The Third Circuit did not issue a formal opinion in this case, but instead a judgment order affirming the decision of the District Court. App., *infra*, 1a-2a. Therefore, the Third Circuit adopted the District Court's reliance upon *Van Orman v. American Ins. Co.*, 680 F.2d 301, 313 (3rd Cir. 1982) in which the court held that ERISA's schedule of asset allocation priorities under 29 U.S.C. § 1344(d) with respect to the termination of an overfunded contributory pension plan did not create any pre-

termination rights in the surplus for plan participants. The Third Circuit again stated this position in *Malia v. General Electric*, 23 F.3d 828 (3rd Cir. 1994) wherein the court held that 29 U.S.C. § 1314(d), when read in conjunction with 29 U.S.C. § 1058, did not together create any rights in a contributory plan surplus for participants prior to plan termination.[11]

In *Walling v. Brady, et al.*, 119 F.3d 233 (3rd Cir. 1997) the Third Circuit held that the amendment of an overfunded, multi-employer, non-contributory pension plan to create an additional monthly subsidy to offset retiree health care costs for most, but not all, participants in the plan did not violate ERISA's anti-inurement and exclusive benefit rules under 29 U.S.C. §§ 1103(c)(1) and 1104.[12] Express reliance was placed upon this Court's holding in *Lockheed Corp. v. Spink*, __ U.S. __, 116 S. Ct. 1783, 135 L. Ed. 2d 153 (1996) that fiduciary duties do not attach to a plan sponsor's decision to amend a plan to create new benefits.

The Third Circuit is aligned with the Seventh Circuit's decision in *Johnson v. Georgia Pacific Corporation*, 19 F.3d 1184 (7th Cir. 1994). In *Johnson*, retiree participants challenged an increase in benefits for current employees intended to exhaust the existing contributory pension plan surplus because there was no corresponding increase in the benefits payable to retired participants. The retirees asserted the proposed increase violated their property rights in the plan surplus the existence of which was attributable, in part, to their mandatory employee

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11. ERISA at 29 U.S.C. § 1058 precludes a reduction in the accrued benefits of plan participants in the context of a plan merger.

12. The Third Circuit announced its holding in *Walling* on July 30, 1997 which was six days before its entry of the judgment order in this matter. The court's opinion does not indicate whether the plan was contributory or non-contributory.

contributions made while working for Georgia-Pacific Corporation. The court concluded that a defined benefit pension plan gives former and current employees property interests in their pension benefits but not the plan assets. *See Johnson*, 19 F.3d at 1188.[13]

2. By contrast, in *Jacobson v. Hughes Aircraft Company*, 105 F.3d 1288 (9th Cir. 1997) the Ninth Circuit reversed a Rule 12(b)(6) dismissal of a complaint wherein retiree participants in an overfunded, contributory defined benefit plan alleged that the plan sponsor breached the anti-inurement and exclusive benefit rules of ERISA at 29 U.S.C. §§ 1103(c)(1) and 1104(a)(1) by using surplus plan assets to fund new categories of plan benefits. The facts in *Jacobson* bear an eerie resemblance to those in this case. The plan sponsor attempted to use the plan surplus to fund a special early retirement program for current employees and to fund a newly established non-contributory pension plan for employees who had never made employee contributions to the first plan. In *Jacobson*, like the present matter, the District Court had granted the employer's motion to dismiss under Rule 12(b)(6). Unlike the present controversy, the Ninth Circuit reversed the District Court and determined that the plaintiffs had stated claims under the anti-inurement and exclusive benefit rules on which relief could be granted. *See Jacobson*, 105 F.3d at 1296, 1298. The court should grant certiorari to resolve this conflict.

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13. At least two other courts of appeal have concluded that participants in a *non-contributory* pension plan have no rights in the plan surplus. In *Siskind v. Sperry Retirement Program*, 47 F.3d 498 (2nd Cir. 1995) the court held that a plan sponsor was free, irrespective of the ERISA's exclusive benefit rule at 29 U.S.C. § 1104 to amend a *non-contributory* pension plan to create another class of benefits payable from the plan surplus. In *Borst v. Chevron Corporation*, 36 F.3d 1308 (5th Cir. 1994), the court held that the participants in a *non-contributory* pension plan did not have any proprietary interest in the plan surplus because the plan provisions did not create such rights.

B. Whether The Sponsor Of An Overfunded Contributory Pension Plan Is Free To Use Surplus Assets To Fund New Categories Of Benefits Without Regard To The Rights Of Participants Whose Contributions Have Created The Surplus Is A Question Of Exceptional And Recurring Importance.

1. As we have explained above, the Third Circuit in *Van Orman, Malia*, and again in this case, has determined that participants have no interest based upon 29 U.S.C. §§ 1054 and 1344 or the fiduciary duty provisions of ERISA. Since the Third Circuit rendered its decisions in *Van Orman* and *Malia*, the Ninth Circuit, while this case was pending before the court of appeals, issued its decision in *Jacobson*.[14] Various courts have grappled with the issue of whether pension plan participants have an interest in the surplus assets of overfunded non-contributory plans. *See, e.g., Holliday v. Xerox Corporation*, 732 F.2d 548 (6th Cir.), *cert. denied*, 469 U.S. 917, 83 L. Ed. 2d 229, 105 S. Ct. 294 (1984); *Borst v. Chevron Corporation, supra*; *Siskind v. Sperry Retirement Program, supra*; and *Walling v. Brady, supra*, all of which concern non-contributory plans. In the contributory plan arena, *see Johnson v. Georgia-Pacific Corporation, supra*; *Jacobson v. Hughes Aircraft Company, supra*; *Malia v. General Electric, supra*; and *In re: Gulf Pension Litigation*, 764 F. Supp. 1149 (S.D. Texas 1991). The outcomes in cases involving non-contributory plans, *i.e.*, that participants have no interest in the plan surplus, have been uniform.[15] However, as discussed above, there is now a clear-cut division among the courts of appeal in the contributory plan arena.

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14. On October 23, 1997 the Ninth Circuit issued an order denying the petition for rehearing and the suggestion for rehearing en banc. There is no available official citation for that order, however, it is reported at 1997 U.S. App. LEXIS 29088. The original decision of the Ninth Circuit was filed January 23, 1997.

15. *See Trenton v. Scott Paper*, 832 F.2d 806 (3rd Cir. 1987); and *I.U.E. v. Murata Erie North America, Inc.*, 980 F.2d 889 (3rd Cir. 1992).

2. The petitioners' concerns about Conrail's continual siphoning of surplus funds from the Supplemental Plan are driven by its cumulative effects upon the financial security backing the payment of their benefits from the plan. As the Seventh Circuit in *Johnson v. Georgia Pacific Corporation*, 19 F.3d at 1188 stated:

> Consider what the "surplus" of a defined benefit plan is. It is not a pile of assets stacked in the corner. It is instead an accounting construct. The plan determines the value of its assets — stocks, bonds, real property, cash, and so on. It also estimates the cost of fulfilling all of the promises to pay vested benefits. The former computation yields the asset side of the balance sheet, the latter computation the liability side. The difference between these is the "surplus" or "deficit" (depending on whether the number is positive or negative), which appears on the debit side of the balance sheet to make the two columns tally.

The growth in the Supplemental Plan surplus has paralleled the resurgence of the stock and bond markets since October, 1987. The experience of the Supplemental Plan is not unique as many retirement plans have reaped handsome profits attributable to the continuing bull markets. However, the divergence of the courts of appeal treating the issue of whether participants have any interest in the surplus assets of a contributory plan has injected a dose of uncertainty into the equation stated in *Johnson v. Georgia-Pacific Corporation*.

The petitioners recognize that Conrail has the right to use that portion of the Supplemental Plan surplus attributable to its contributions (which ceased in 1984) and those of the Merged Railroads, the PRR and NYC. The petitioners want to prevent any further inroads against that portion of the surplus attributable

to contributions by them, and other participants in the Supplemental Plan, the Merged Plans or the PRR Plan. The petitioners have not sought an increase in benefits. Instead they have sought declaratory and injunctive relief pursuant to ERISA at 29 U.S.C. § 1132(a)(1) and (3) to establish and protect their interest in the surplus assets of the Supplemental Plan attributable to their contributions. C.A. App. A602-A604. Clarification is necessary so that plan sponsors and participants may govern their actions accordingly. The court should grant certiorari to decide this recurring and important issue.

C. The Third Circuit Erroneously Held That Petitioners Have No Interest In That Portion Of The Supplemental Plan Surplus Attributable To Their Employee Contributions.

In *Jacobson*, 105 F.3d at 1293, the Ninth Circuit correctly stated this Court's holding in *Lockheed Corporation v. Spink*, __ U.S. __, 116 S. Ct. 1783, 135 L. Ed. 2d 153 (1996) as follows:

> In *Lockheed*, the Supreme Court held that amending an existing pension plan to use surplus assets to fund an early retirement program for participants of the plan does not violate ERISA, so long as other ERISA provisions are not violated.

The District Court and the Third Circuit, in turn, failed to consider the impact of the last subordinate clause in this statement.

The key to the Ninth Circuit's holding in *Jacobson*, was the court's determination that the participants had an interest in the plan surplus attributable to their employee contributions. The court considered the minimum vesting and nonforfeiture requirements of ERISA at 29 U.S.C. § 1053 for accrued benefits derived from employee contributions and the plan termination

allocation of residual assets attributable to employee contributions as evidence of the Congressional intent to distinguish between assets derived from employee and employer contributions. *See Jacobson*, 105 F.3d 1293. The court considered the Fifth Circuit's characterization of the surplus assets of a noncontributory pension plan in *Borst v. Chevron Corporation*, *supra*, wherein the Fifth Circuit stated:

> An entirely employer funded defined benefit plan pension trust is therefore more akin to a gratuitous trust so far as concerns surplus assets, as to which ERISA so markedly distinguishes between those attributable to employee contributions (thus suggesting that employee contributions are not a form of recontributed wages for such purposes). Where a gratuitous trust is fully performed without exhausting the trust estate, a resulting trust of the surplus is presumed to arise in favor of the settlor. *RESTATEMENT (SECOND) TRUST §430.* This principle has been looked to in holding an employer entitled to surplus assets on termination of an employer funded defined benefit pension plan.

See Borst v. Chevron Corporation, 36 F.3d at 1315. In concluding that the *Jacobson* plaintiffs had stated a viable cause of action based upon a violation of the anti-inurement rule, the Ninth Circuit at 105 F.3d 1294 stated:

> Thus, to ignore the distinction between a plan funded solely by employer contributions and a plan funded by both employer and employee contributions would eviscerate the protection provided to employees under ERISA with respect to their employee contributions. We, therefore, hold that when both the employer and its employee contribute to a pension plan, the employee

> does not have sole discretion to use that part of a plan's asset surplus attributable to employee contributions.

In so holding, the Ninth Circuit examined the special protection ERISA affords to accrued benefits attributable to employee contributions under: (i) the vesting provisions in 29 U.S.C. § 1053; and (ii) the asset allocation priorities on the termination of a plan under 29 U.S.C. § 1344(d)(3)(A). These are precisely the same issues which the petitioners have raised. C.A. App. A597-A599. Interestingly, the Ninth Court at 105 F.3d 1294-1295, n.4, cited the concerns voiced by the petitioners here, and mentioned in *Johnson v. Georgia-Pacific Corporation*, 19 F.3d at 1187:

> . . . As the Seventh Circuit recently noted in a case involving an employer's decision to amend a pension plan to use surplus assets to increase the benefits of current employees without increasing the pension benefits of retired participants: A transaction of this kind would reduce the expected value of the benefits. Writing additional promises without increasing the assets available to fund those promises increases the risk that at some time in the future — if, perhaps the economy takes a downturn and . . . . [the employer] is unable to top up the plan — the trust will be unable to satisfy all its obligations . . . . [thus] increasing the risk of nonpayment. . . . The Supreme Court in *Lockheed* also recognized that commercial bargains that present a special risk of plan underfunding are the kind of transactions that ERISA was intended to prohibit.

Both the District Court and the Third Circuit have failed to appreciate the significance of this "special risk" posed by Conrail's raids upon the Supplemental Plan surplus. However, the Ninth Circuit has had no difficulty in discerning the possible

dangers to the financial integrity of a pension plan caused by similar incursions and correctly concluded that contributory plan participants can state a viable cause of action under 29 U.S.C. § 1103(c)(1) challenging the effects of such amendments upon that integrity. *See Jacobson*, 105 F.3d at 1294-1295, n.4.

Like the plaintiffs in *Jacobson*, the petitioners have assailed the use of the surplus assets of the Supplemental Plan to fund the early retirement or SVP program as an infringement upon their interest in those surplus assets and as violations of both the anti-inurement and exclusive benefit rules of ERISA at 29 U.S.C. §§ 1103(c)(1) and 1104. Like *Hughes Aircraft*, Conrail has elected to draw upon the plan surplus rather than its own coffers by amending the plan to its own benefit and using the asset surplus to offer early retirement incentives and retiree health benefits to current employees who did not make any employee contributions to the Supplemental Plan. The Third Circuit ignored the existence of causes of action against Conrail based upon alleged violations of the anti-inurement rule at 29 U.S.C. § 1103(c)(1) and the exclusive benefit rule at 29 U.S.C. § 1104(a)(1) because it did not consider whether the petitioners might have an interest in the Supplemental Plan surplus other than that analyzed in *Van Orman v. American Insurance Co.*, *supra*. In *Jacobson*, the Ninth Circuit recognized such causes of action because *Hughes Aircraft* used the surplus assets of the contributory plan to fund a non-contributory plan for current employees who had never participated in, or contributed to the original contributory plan. The court stated:

> If employees contribute to the plan, the employer has a fiduciary duty to the employees when it amends the plan to use an asset surplus. In essence, when a plan is funded by both employer and employee contributions, both the employer and the employees are co-settlors of the plan.

See Jacobson, 105 F.3d at 1296.

The petitioners have stated the same claim for relief. C.A. App. A596-A599. Conrail has appropriated the surplus assets of the Supplemental Plan to fund new categories of benefits for non-agreement, *i.e.*, management, employees who never contributed to that plan or any of the Merged Plans. Conrail did so with complete disdain for the petitioners as co-settlors. While Conrail may be free to use the employer-generated portion of the surplus, its ability to use the employee-generated surplus must be circumscribed by its fiduciary duties under 29 U.S.C. § 1103(c)(1) and § 1104(a)(1) and the petitioners' interest in the Supplemental Plan surplus derived from their contributions.

CONCLUSION

The Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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APPENDIX A — JUDGMENT ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT DATED AUGUST 5, 1997

UNITED STATES COURT OF APPEALS
FOP THE THIRD CIRCUIT

No. 96-1920

PAUL J. ENGELHART; WILLIAM J. MCILFATRICK; H. C. KOHOUT; CARL C. BRANDT; LAWRENCE CIRILLO; CHARLES D. NESTER; THOMAS F. MEEHAN, JR.; JACQUELINE A. MACE; DONALD E. KRAFT; ROBERT E. GRAHAM, ON BEHALF OF THEMSELVES AND ALL OTHERS SIMILARLY SITUATED, (ENGELHART SUBCLASS); WILLIAM J. MCILFATRICK, ON BEHALF OF HIMSELF AND ALL OTHERS SIMILARLY SITUATED, (MCILFATRICK DISABILITY SUBCLASS); WILLIAM J. MCILFATRICK, ON BEHALF OF HIMSELF AND ALL OTHERS SIMILARLY SITUATED (MCILFATRICK OFFSET SUBCLASS); JACQUELINE A. MACE, ON BEHALF F HERSELF AND ALL OTHERS SIMILARLY SITUATED (MACE SUBCLASS),

Appellants

v.

CONSOLIDATED RAIL CORPORATION; SUPPLEMENTAL PENSION PLAN OF CONSOLIDATED RAIL CORPORATION; THE PENSION ADMINISTRATION COMMITTEE OF THE SUPPLEMENTAL PENSION PLAN OF CONSOLIDATED RAIL CORPORATION; MELLON BANK N.A., TRUSTEE OF THE SUPPLEMENTAL PENSION PLAN OF CONSOLIDATED RAIL CORPORATION

Appendix A

Appeal from the United States District Court
for the Eastern District of Pennsylvania
(D.C. Civ. No. 92-cv-07056)
District Judge: Honorable Ronald L. Buckwalter

Argued
June 13, 1997
Before: MANSMANN, NYGAARD and ROSENN,
Circuit Judges.

JUDGMENT ORDER

After consideration of all contentions raised by the appellant, it is

ADJUDGED AND ORDERED that the judgment of the district court be and is hereby affirmed. We do not reach the issue of whether the district court abused its discretion in refusing to certify the redefined McIlfatrick Offset Subclass because of our affirmance of the district court's decision on the merits.

Costs taxed against the appellants.

BY THE COURT,

s/ illegible
Circuit Judge

AUG -5 1997

Attest:

s/ Bradford A. Baldus
Bradford A. Baldus, Chief Deputy Clerk

APPENDIX B — MEMORANDUM AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA FILED AUGUST 16, 1993

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

CIVIL ACTION

NO. 92-7056

PAUL J. ENGELHART *et al.*,

Plaintiff

v.

CONSOLIDATED RAIL CORPORATION, *et al.*,

Defendants

MEMORANDUM

BUCKWALTER, J. August 16, 1993

Plaintiffs, Engelhart, McIlfatrick, Mace and Graham represent several classes of plaintiffs seeking redress for defendants' alleged breach of fiduciary duties and improper calculation of pension benefits in contravention of the Employee Retirement Security Act of 1974 ("ERISA"), 29 U.S.C. §§ 1001 *et seq.* In addition, plaintiffs assert common law claims based upon breach of contract and breach of fiduciary duty, for which they seek monetary, declaratory, and injunctive relief. This action is presently before the Court upon defendants' motion to dismiss certain Counts of plaintiffs' complaint pursuant to Federal Rule of Civil Procedure 12(b)(6).

Appendix B

For the following reasons, defendants' motion to dismiss is GRANTED IN PART and DENIED IN PART in accordance with the terms of this memorandum and accompanying order.

I. Standard of Review

It is well settled that a motion to dismiss founded upon Federal Rule of Civil Procedure 12(b)(6) is designed to test the "formal sufficiency" of a plaintiff's complaint. *Kurz v. Mairone*, No. 86-5587, 1987 WL 28360 (E.D. Pa. 1987). In so doing, I must accept all allegations of plaintiffs' complaint as true, and will construe the allegations in the light most favorable to the plaintiffs. *Fiorentino v. Converse*, 705 F. Supp. 253 (E.D. Pa. 1989), (citing *Jenkins v. McKeithen*, 395 U.S. 411, 421-22 (1969)). The central inquiry to evaluate a motion to dismiss is whether the averments of plaintiffs' complaint as filed entitle plaintiffs to produce evidence to support their allegations. *Kurz v. Mairone*, No. 86-5587, 1987 WL 28360 (E.D. Pa. 1987). Plaintiffs' complaint will not be dismissed "unless it appears beyond doubt that the plaintiffs can prove no set of facts in support of [their] claims which would entitle [them] to relief." *Id.*, (citing *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)).

II. Discussion

A. Did Conrail's Creation of the Early Retirement Program and Funding of Health Benefits for Former Employees Violate ERISA?

Counts I and III of plaintiffs' complaint allege, *inter alia*, that defendants Conrail, Mellon and PAC breached their fiduciary duties by using surplus assets attributable to employee contributions "to fund the SVP benefits [early retirement

program] . . . [and] . . . the retiree health care account," which impermissibly granted defendants a reversion of surplus assets in contravention of the terms of the Supplemental Plan ("Supp. Plan") and the fiduciary duty standards set forth in ERISA. (Plaintiffs' Complaint, ¶¶ 74 f-g).[1] Defendants move to dismiss Counts I and III of plaintiffs' complaint, arguing that amending the Supp. Plan to create the Early Retirement Program and funding of the Health Benefits Account is not subject to ERISA's fiduciary duty standards.[2]

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1. Count III generally alleges that defendants breached their fiduciary duties pursuant to ERISA and common law. (Plaintiffs' Complaint, Count III).

2. As a preliminary matter, defendants assert that plaintiffs have failed to demonstrate that Conrail's allegedly improper acts *in fact* diminished the employee generated surplus. Without identifying which portion of the surplus assets are attributable to employee contributions, defendants argue that there can be no determination of whether Conrail impermissibly distributed any portion of the surplus.

At this juncture, however, plaintiffs' failure to apportion the surplus assets between employee contributions and employer contributions does not warrant dismissal of plaintiffs' complaint. At this stage of the litigation, Federal Rule of Civil Procedure 8(a) requires plaintiffs to plead "a short and plain statement of the claim showing that the pleader is entitled to relief," which is a pleading burden that plaintiffs have satisfied by the allegation that defendants inappropriately diverted surplus assets to the detriment of the plan's participants. Although it is clear that the merits of plaintiffs' allegations are dependent upon a valuation of surplus assets attributable to employee contributions, for the purposes of evaluating defendants' motion to dismiss, I will construe the facts in the light most favorable to the plaintiff and assume that the creation of the Early Retirement Plan and the Health Benefits Account did in fact diminish the employee-generated surplus.

Appendix B

It is undisputed that the plaintiffs have no specific pre-termination rights in the benefit plan surplus, and further, that pre-termination rights to pension benefits are governed by ERISA's fiduciary duty provisions, 29 U.S.C. §§ 1103 - 1106. *Van Orman v. American Ins. Co.*, 680 F.2d 301, 313 (3d Cir. 1982) ("we believe that Congress intended the statutory provisions prescribing minimum standards of fiduciary conduct . . . to govern employees' pre-termination rights to the funds assets, whether surplus or not."). Therefore, a proper analysis of whether Counts I and III of plaintiffs' complaint should be dismissed must begin with an overview of ERISA's statutory scheme regarding fiduciaries and their duties.

ERISA was "designed to promote the interests of employees and their beneficiaries in employee benefit plans." *Nazay v. Miller*, 949 F.2d 1323, 1329 (3d Cir. 1991) (citing *Shaw v. Delta Air Lines Inc.*, 463 U.S. 85, 90 (1983)). In enacting ERISA, Congress did not impose a duty on employers to provide healthcare benefits to employees; however, once an employee benefit plan is established, ERISA governs issues related to the appropriate *administration* of benefit plans, rather than with the precise design of the plan. *Nazay*, 949 F.2d at 1329 (citations omitted) (emphasis in original).

To ensure the proper administration of benefit plans, ERISA imposes a heightened standard of care on fiduciaries, who are defined as a persons who:

> (i) . . . exercise any discretionary authority or discretionary control respecting management of such plan or exercise any authority or control respecting management or disposition of assets, (ii) render investment advice for a fee or other compensation,

> direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so or (iii) has any discretionary authority or discretionary responsibility in the administration of such plan.

29 U.S.C. § 1002(21)(A).

Pursuant to this standard, fiduciaries are obligated to "discharge [their] duties with respect to a plan solely in the interest of the participants and beneficiaries . . . for the exclusive purpose of . . . providing benefits to participants and their beneficiaries . . . ." 29 U.S.C. § 1004(a)(1)(A)(i).

Employers such as defendant Conrail occasionally find themselves in the precarious position of serving as "plan administrators" and "plan designers," but are only subject to ERISA's fiduciary duty standards to the extent that they function as plan administrators: fiduciary duties do not attach to ordinary business decisions, such as plan design decisions. *Hozier v. Midwest Fasteners, Inc.*, 908 F.2d 1155, 1158 (3d Cir. 1990) (citations omitted); *Nazay*, 949 F.2d at 1329 (citing *Belade v. ITT Corp.*, 909 F.2d 736, 738 (2d Cir. 1990)) (employers will only be deemed a fiduciary if they act in the capacity of a benefit plan administrator and owe no fiduciary duty when acting as business managers). Therefore, if Conrail's decision to amend the Supp. Plan constitutes a "plan administration" decision, Conrail will be subject to ERISA's fiduciary duty provisions and defendants' motion to dismiss Counts I and III must be denied. *Hozier*, 908 F.2d at 1159.

It has been consistently held that a decision to amend an employee benefit plan is not an "administrative" decision and

is therefore not actionable pursuant to ERISA's fiduciary duty provisions. In fact, virtually every circuit has rejected the proposition that ERISA's fiduciary duties attach to an employer's decision to amend an employee benefit plan.[3] *Hozier*, 908 F.2d at 1161 (citing *Sutton v. Weirton Steel Div.*, 724 F.2d 406 (4th Cir. 1983); *Phillips v. Amoco Oil Co.*, 799 F.2d 1464 (11th Cir. 1986); *Musto v. American General Corp.*, 861 F.2d 897 (6th Cir, 1988)); *Nazay*, 949 F.2d at 1330; *Gluck v. Unisys Corp.*, No. 90-1510, 1991 U.S. Dist. LEXIS 1370 at * 12-13 (E.D. Pa. Feb. 1, 1991), *aff'd in part & rev'd in part, Gluck v. Unisys Corp.*, 960 F.2d 1168 (3d Cir. 1992)). Therefore, plaintiffs' allegation that defendant Conrail's amendment of the Supp. Plan violated ERISA is without merit. The fact that plaintiffs allege that defendants improperly received a reversion of surplus assets as a result of creating the Early Retirement Program and the Health Benefits Account is of no consequence: a fiduciary's implementation of a plan that incidentally benefits an employer is not a breach of fiduciary duty. *See Gluck v. Unisys*, 1991 U.S. Dist. LEXIS 1370 at *13.

Moreover, the creation of the health benefits account through the use of surplus assets is exempt from ERISA's fiduciary duty standards. Section 420 of the Internal Revenue

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3. Plaintiffs cite several cases to support their contention that the plan amendment is actionable as a breach of fiduciary duty because defendants impermissibly received a reversion of surplus assets attributable to employee contributions. Plaintiffs' cases, however, are distinguishable because they relate to employers recouping surplus assets upon a benefit plan's termination rather than cases involving plan amendments. (Plaintiffs' Response Memorandum of Law Contra Defendants' Motion to Dismiss, p. 25, (citing *International Union of Electronic, etc. v. Murata Erie North America, Inc.*, 980 F.2d 889 (3d Cir. 1992))).

Appendix B

Code allows employers to transfer excess assets from a pension plan to a health benefits account which is part of the plan, and to use the transferred assets to reimburse the employer for the cost of retiree health benefits provided to plan participants. 26 U.S.C. § 420; *Chemtech Industries, Inc. v. Goldman Fin. Group, Inc.*, 809 F. Supp. 729, 733-34 (E.D. Mo. 1992).

Based upon the aforementioned principles, paragraphs 74 f & g of Count I is dismissed.[4]

B. Are Plaintiffs' Claims for Benefits Improperly Asserted Under ERISA's Fiduciary Duty Provisions?

Defendants move to dismiss Counts VI, X, XIII, and XVI of plaintiffs' complaint, arguing that plaintiffs Graham, McIlfatrick and Mace improperly asserted claims for individual increased benefits pursuant to ERISA's fiduciary duty provisions.[5] Defendants argue that any liability for breach of

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4. Defendants move to dismiss Counts I and III based upon the argument that amending the Supp. Plan to create the Early Retirement Program and the Health Benefits Account is not actionable pursuant to ERISA's fiduciary duty provisions. However, Count I of plaintiff's complaint generally alleges, *inter alia*, that defendants also inappropriately administered the Supp. Plan by paying "unwarranted, exorbitant and unreasonable administrative expenses that should have been payable directly from Conrail operating revenues." (Plaintiffs' Complaint, ¶ 74 e). I find that the remaining allegations of Counts I and III of plaintiffs' complaint are sufficient to state a claim upon which relief can be granted.

5. These Counts request, *inter alia*, that defendants pay members of each subclass all pension benefits which they have been denied: (1) by application of the age reduction factors plus interest. (Plaintiffs' Complaint, ¶ 107 e); (2) by use of their estimated, rather than actual, (Cont'd)

fiduciary duty must be payable to the plan, rather than the individual participants of the plan. Accordingly, defendants contend that plaintiffs' request for increased individual benefits is not cognizable pursuant to ERISA's fiduciary duty provisions.

Even assuming that plaintiffs can establish that defendants acted as fiduciaries and breached their fiduciary duties pursuant to ERISA, plaintiffs' requested relief may not be granted. Liability for breach of fiduciary duty is governed by ERISA § 409, which provides that "[a]ny person who is a fiduciary with respect to a plan who breaches any of the . . . duties imposed upon fiduciaries by [ERISA] shall be *personally liable to make good to such plan any losses to the plan resulting from each such breach.*" 29 U.S.C. § 1109(a) (emphasis added). This liability accrues to the plan itself, not to the participants suing in their individual capacities. *Id.*; *see also*, *Hozier*, 908 F.2d at 1162 n.7.

Accordingly, paragraphs 107(e), 134(e), 162(e), and 185(b) of plaintiffs' complaint are dismissed; however, plaintiffs are granted leave to amend these paragraphs in accordance with the above within ten days from the date of this memorandum and order.[6]

(Cont'd)

Primary Railroad Retirement Benefit, (Plaintiffs' Complaint, ¶ 135 e); (3) by the application of early retirement age reduction factors to their accrued benefits attributable to their service with any of the Merged Railroads, plus interest, (Plaintiffs' Complaint, ¶ 162 e); and, (4) by reducing Graham's accrued pension benefits based upon his leave of absence, (Plaintiffs' Complaint, ¶ 185 b).

6. Federal Rule of Civil Procedure 15(a) provides in relevant part that: "[a] party may amend the party's pleading once as a matter of course

(Cont'd)

C. Are Plaintiffs' ERISA Claims Improperly Asserted Against Conrail and Mellon Bank?

Defendants additionally argue that Counts IV, VIII, XI, and XIV should be dismissed insomuch as they allege claims against defendants Conrail & Mellon Bank. First, defendants assert that before a party can be held liable for the denial of benefits, plaintiffs must demonstrate that the party participated in the decision regarding benefits. Defendants specifically note that the complaint contains no allegations that Conrail or Mellon Bank were responsible for the alleged improper calculations of benefits, and further, that plaintiffs McIlfatrick, Mace & Graham allege that the PAC ultimately denied each of their requests for a re-calculation of benefits. Second, defendants similarly move to dismiss Counts I and III of plaintiffs' complaint as to defendant Mellon Bank, arguing that the Engelhart class has failed to sufficiently allege that Mellon is liable for any of the claimed breaches of fiduciary duty.

Plaintiffs respond by alleging that defendants Mellon Bank and PAC, under the direction and control of Conrail, have violated their fiduciary duties imposed by ERISA. Plaintiffs contend that these defendants are proper insofar as they controlled or influenced decisions regarding plan amendments,

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(Cont'd)

at any time before a responsive pleading is served . . . [o]therwise, a party may amend the party's pleading only by leave of court or by written consent of the adverse party; and leave shall be freely given when justice so requires." Fed. R. Civ. P. 15(a). It is well settled that the decision to grant plaintiffs leave to amend is "within the sound discretion of the district court." *Bruvarny v. Consolidated Rail Corp.*, No. 89-2823, 1990 U.S. Dist. Lexis 14808, at *1 (E.D. Pa. Nov. 2, 1990), (citing *Howze v. Jones & Laughlin Steel Corp.*, 750 F.2d 1208 (3d Cir. 1984)).

plan interpretation, and payment of benefits. Moreover, plaintiffs contend that if Conrail has sufficient power over Mellon Bank, Mellon may likewise be in violation of ERISA's fiduciary duty provisions because Mellon, as a trustee, has a fiduciary duty to preserve the financial security of the pension fund.

It is clear that an employer can be held liable for the denial of pension benefits if the employer has "controlled or influenced the administrator's decision regarding the award of benefits." *Adamo v. Anchor Hocking Corp.*, 720 F. Supp. 491, 498 (W.D. Pa. 1989). In construing the facts in the light most favorable to the plaintiffs, plaintiffs' general allegation that "defendants" were responsible for the denial of benefits has the requisite degree of specificity necessary to overcome defendants' motion to dismiss. Although PAC is the committee responsible for the administration of the employee benefit plan, discovery on this issue may later yield evidence concerning whether Conrail and Mellon Bank "influenced or controlled" the decision making process with respect to the issuance of benefits. Accordingly, although plaintiffs have not specifically alleged that Conrail or Mellon Bank made decisions regarding the award of benefits, at this juncture, it would be premature to dismiss Counts IV, VIII, XI, and IVX as to defendants Conrail and Mellon, as plaintiffs have successfully asserted facts that if proven, may entitle them to relief.[7]

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7. Plaintiffs contend that the gravamen of Graham's claim is that defendants breached their fiduciary duty by failing to advise him that his leave of absence would adversely affect his pension benefits. Plaintiffs correctly note that "misleading communications to plan participants regarding plan administration . . . will support a claim for breach of fiduciary duty." *Berlin v. Michigan Bell Telephone Co.*, 858 F.2d 1154, 1163 (6th Cir. 1988). Therefore, defendants' motion to dismiss Graham's claims is appropriately denied.

With respect to defendants' request to dismiss Counts I and III as these Counts relate to defendant Mellon Bank, defendants acknowledge that a fiduciary is not liable for the breach of the responsibility allocated to another fiduciary "except to the extent it participates knowingly in the breach, or fails to act reasonably in discharging its own responsibilities and thereby enables the other fiduciary to commit the breach, or it has knowledge of a breach by such other fiduciary and makes no reasonable effort under the circumstances to remedy the breach." (Defendants' Motion to Dismiss, p. 26, (citations omitted)). Therefore, I similarly find that it would be inappropriate to dismiss Mellon Bank as a defendant because discovery may illuminate Mellon's involvement, if any, in decisions regarding the administration of pension benefits.

D. Are Plaintiffs' ERISA Claims Barred by the Statute of Limitations?

Defendants argue that the McIlfatrick and Mace classes assert claims pursuant to ERISA for benefits allegedly due under the Supplemental Plan, and re-calculation of benefits paid prior to December 9, 1989. Defendants argue that although there is no statute of limitations for non-fiduciary claims brought pursuant to the civil enforcement provisions of § 502, the most analogous state statute of limitations is the three year limitations period of the Pennsylvania Wage Payment & Collection Law. Accordingly, defendants argue that plaintiffs' claims for benefits three years prior to the commencement of this suit are precluded by the statute of limitations.

Defendants similarly argue that the Engelhart class asserts ERISA claims based upon alleged improper payment of administrative expenses, which are time barred to the extent that

they are based upon payments made prior to December 9, 1986. To support this contention, defendants cite ERISA § 413 which provides that no action can be commenced with respect to the fiduciary's breach of any duty six years after the date of the last action which constituted part of the breach. Accordingly, defendants assert that since the last improper act alleged by plaintiffs occurred in 1986, any claims prior to December 9, 1986 are time barred pursuant to this section.

Plaintiffs concede that members of the Mace and McIlfatrick classes who are in pay status can only recover benefits due and payable since December 9, 1989, except to the extent that the statute of limitations may be tolled. However, plaintiffs proffer no arguments to support tolling of the statute of limitations. Accordingly, the claims of the McIlfatrick and Mace subclasses payable prior to December 9, 1989 are dismissed.

With respect to the claims regarding the Engelhart class, ERISA § 1113 bars any action for breach of fiduciary duty after the earlier of "six years after the date of the last action which constituted part of the breach or violation . . ." or "three years after the earliest date on which the plaintiff had actual knowledge of the breach or violation."[8] 29 U.S.C. § 1113; *see also*, *Starr v. JCI Data Processing, Inc.*, 767 F. Supp. 633, 637 (D.N.J. 1991). The Engelhart plaintiffs allege that beginning in 1986 and "continuing to the present," the Supp. Plan has been used by defendants as the "source to pay various expenses under the guise of administrative expenses which had heretofore been paid by Conrail." (Plaintiffs' Complaint, ¶ 45). Plaintiffs, therefore,

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8. Defendants seek to dismiss these claims on the basis of the six year statute of limitations but reserves the right to raise the three year statute of limitations as a defense in a motion for summary judgment. (Defendants' Motion to Dismiss, p. 31, n.32).

are alleging that defendants presently use Supp. Plan funds in contravention of the provisions of ERISA and the language of the plan itself. Based upon a reading of § 1113, it is clear that the Engelhart plaintiffs' are entitled to pursue the propriety of their allegations that defendants breached their fiduciary duties by using the Supp. Plan to make unauthorized expenditures in violation of ERISA.

Accordingly, defendants' motion to dismiss plaintiffs' ERISA claims is denied.

E. Does ERISA Preempt Plaintiffs State Law Claims?

Defendants' last argument in support of their motion to dismiss plaintiffs' complaint is that plaintiffs' remaining state common law claims are preempted by ERISA. Plaintiffs allege, however, that their claims are not based upon state common law, but upon federal common law created by federal courts to supplement ERISA's statutory scheme. In their reply memorandum, defendants concede that plaintiffs can indeed bring a claim pursuant to federal common law, but argue for dismissal of these claims because ERISA's statutory scheme is comprehensive enough to address the common law claims asserted by plaintiffs. Having conceded that plaintiffs can in fact assert federal common law claims, dismissal of these claims is unwarranted. Should defendants later deem it appropriate to challenge the merit of plaintiffs' common law claims, defendants are free to raise this issue upon a motion for summary judgment.

An appropriate order follows.

Appendix B

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

CIVIL ACTION

NO. 92-7056

PAUL J. ENGELHART *et al.*,

Plaintiff

v.

CONSOLIDATED RAIL CORPORATION, *et al.*,

Defendants

ORDER

AND NOW, this 16th day of August, 1993, in consideration of the Motion to Dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6) filed on behalf of defendants Consolidated Rail Corporation, Mellon Bank, N.A., Supplemental Pension Plan of Consolidated Rail Corporation, and Pension Administration Committee of the Supplemental Pension Plan of Consolidated Rail Corporation, Plaintiffs' response thereto, and Defendants' Reply Memorandum, it is hereby ORDERED and DECREED that Defendants' Motion to Dismiss is GRANTED in part and DENIED in part in accordance with the following:

(1) Defendants' Motion to Dismiss Counts I and III in their entirety is DENIED; Count I, paragraphs 74 f & g are DISMISSED;

(2) Defendants Motion to Dismiss Counts VI, X, XIII, and XVI in their entirety is DENIED; Count VI, paragraph 107(e), Count X, paragraph 134(e), Count XIII, paragraph 162(e), and Count XVI, paragraph 185(b) are DISMISSED; however, plaintiffs are granted leave to amend these paragraphs in accordance with the above within ten days from the date of this memorandum and order;

(3) Defendants' Motion to Dismiss Counts IV, VIII, XI, and XIV as to Defendants Conrail and Mellon Bank, and Counts I and III as to Defendant Mellon Bank is DENIED;

(4) Defendants' Motion to Dismiss Plaintiffs' ERISA claims based upon the statute of limitations is DENIED;

(5) Defendants' Motion to Dismiss Plaintiffs' common law claims is DENIED.

IT IS SO ORDERED.

BY THE COURT:

s/ Ronald L. Buckwalter
RONALD L. BUCKWALTER, J.

APPENDIX C — DENIAL OF PETITION FOR REHEARING OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT FILED AUGUST 29, 1997

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 96-1920

PAUL J. ENGELHART; WILLIAM J. MCILFATRICK; H. C. KOHOUT; CARL C. BRANDT; LAWRENCE CIRILLO; CHARLES D. NESTER; THOMAS F. MEEHAN, JR.; JACQUELINE A. MACE; DONALD E. KRAFT; ROBERT E. GRAHAM, ON BEHALF OF THEMSELVES AND ALL OTHERS SIMILARLY SITUATED, (ENGELHART SUBCLASS); WILLIAM J. MCILFATRICK, ON BEHALF OF HIMSELF AND ALL OTHERS SIMILARLY SITUATED, (MCILFATRICK DISABILITY SUBCLASS); WILLIAM J. MCILFATRICK, ON BEHALF OF HIMSELF AND ALL OTHERS SIMILARLY SITUATED (MCILFATRICK OFFSET SUBCLASS); JACQUELINE A. MACE, ON BEHALF F HERSELF AND ALL OTHERS SIMILARLY SITUATED (MACE SUBCLASS),

Appellants

v.

CONSOLIDATED RAIL CORPORATION; SUPPLEMENTAL PENSION PLAN OF CONSOLIDATED RAIL CORPORATION; THE PENSION ADMINISTRATION COMMITTEE OF THE SUPPLEMENTAL PENSION PLAN OF CONSOLIDATED RAIL CORPORATION; MELLON BANK N.A., TRUSTEE OF THE SUPPLEMENTAL PENSION PLAN OF CONSOLIDATED RAIL CORPORATION

Appendix C

Present: SLOVITER, *Chief Judge*,
BECKER, STAPLETON, MANSMANN, GREENBERG,
SCIRICA, COWEN, NYGAARD, ALITO, ROTH, LEWIS,
MCKEE, and ROSENN*, *Circuit Judges*.

SUR PETITION FOR REHEARING

The petition for rehearing filed by appellants in the above entitled case having been submitted to the judges who participated in the decision of this court and to all other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

BY THE COURT,

s/ Carol Los Mansmann
Circuit Judge

DATED: AUG 29 1997

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* Panel rehearing only.

APPENDIX D — STATUTORY PROVISIONS INVOLVED

Section 403 of the Employee Retirement Income Security Act of 1974, Pub. L. No. 94-406, 88 Stat. 832,875, 29 U.S.C. § 1103(c)(1) provides in pertinent part:

> **(c) Assets of plan not to inure to benefit of employer; allowable purposes of holding plan assets.** (1) Except as provided in paragraph (2), (3), or (4) or subsection (d), or under section 4042 and 4044 [29 USCS §§ 1342, 1344] (relating to termination of insured plans), the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the pan and their beneficiaries and defraying reasonable expenses of administering the plan.

Section 404 of the Employee Retirement Income Security Act of 1974, Pub. L. No. 94-406, 88 Stat. 832, 875, 29 U.S.C. § 1104(a)(1) provides in pertinent part:

> **(a) Prudent man standard of care.** (1) Subject to sections 403(c) and (d) [29 USCS §1103 (c) and (d)], 4042 [29 USCS §1342], and 4044 [29 USCS §1344], a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and —
>
> (A) for the exclusive purpose of:
>
> (i) providing benefits to participants and their beneficiaries; and
>
> (ii) defraying reasonable expenses of administering the plan;

Supreme Court, U. S.
FILED
JAN 26 1998
CLERK

(2)

No. 97-885

In The

Supreme Court of the United States

October Term, 1997

PAUL J. ENGELHART, *et al.*,

Petitioners,

vs.

CONSOLIDATED RAIL CORPORATION, *et al.*,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether ERISA prevents an employer's amendment to a dramatically overfunded defined benefit pension plan to use a small portion of the surplus to benefit existing plan participants, consistent with this Court's decision in *Spink v. Lockheed Corporation*, 116 S. Ct. 1783 (1996).

LIST OF PARTIES

The petitioners are Paul J. Engelhart; William J. McIlfatrick; H.C. Kohout; Carl C. Brandt; Lawrence Cirillo; Charles D. Nester; Thomas F. Meehan, Jr.; Jacqueline A. Mace; Donald E. Kraft and Robert E. Graham. The respondents are Consolidated Rail Corporation; Supplemental Pension Plan of Consolidated Rail Corporation; The Pension Administration Committee of the Supplemental Pension Plan of Consolidated Rail Corporation; Mellon Bank, N.A.; and the Trustee of the Supplemental Pension Plan of Consolidated Rail Corporation.

RULE 29.6 STATEMENT

Consolidated Rail Corporation ("Conrail") is a wholly-owned subsidiary of Conrail, Inc. ("CRR"). CSX Corporation ("CSX") and Norfolk Southern Corporation ("NSC") have acquired all outstanding shares of CRR in connection with a proposed acquisition of CRR, which proposed acquisition is currently pending before the Surface Transportation Board ("STB"). NSC has a 58% equity interest and 50% voting interest in CRR. CSX has a 42% equity interest and a 50% voting interest in CRR. All of the common stock of CRR is held indirectly for the benefit of CSX and NSC and has been placed in a voting trust to avoid unauthorized control of CRR prior to STB approval of the proposed acquisition.

Conrail's subsidiaries, other than wholly-owned subsidiaries, are Indiana Harbor Belt Railroad Company, LMS Partnership, Albany Port Railroad Corporation, Peoria & Pekin Union Railway Co., Lakefront Dock & Railroad Terminal Company, TTX Company, and Belt Railway Company of Chicago.

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OPINIONS BELOW

The judgment order of the court of appeals affirming the district court's grant of respondent Consolidated Rail Corporation's ("Conrail") motion to dismiss on the issues raised in the petition is unreported and is reproduced in the appendix attached to the petition, "Pet. App." at 1a-2a. The district court's opinion granting Conrail's motion to dismiss petitioners' surplus claims is not reported, and is reproduced in the petitioners' appendix, Pet. App. at 3a-17a. The order of the court of appeals denying the petitioners' request for rehearing is not reported, and is reproduced in the petitioners' appendix, Pet. App. at 18a-19a.

STATEMENT OF THE CASE

On April 1, 1976, Consolidated Rail Corporation ("Conrail") created the Employees' Supplemental Pension Plan of Consolidated Rail Corporation (the "ESPP"), a defined benefit pension plan.[1] Petitioners are all former employees of Conrail or its predecessor companies who are participants in the ESPP.

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1. A defined benefit plan is one where the employee, upon retirement, is entitled to receive a fixed periodic payment regardless of the performance of the plan's assets. *Commissioner v. Keystone Consolidated Indus. Inc.*, 508 U.S. 152, 154 (1993).

> A defined benefit plan is distinguished from "a defined contribution" plan (also known as an "individual account" plan), under which the employer typically contributes a percentage of an employee's compensation to an account, and the employee is entitled to the account upon retirement.

Pension Benefit Guar. Corp. v. LTV Corp., 496 U.S. 633, 637 n.2 (1990) (citations omitted). Should poor management of the plan

(Cont'd)

While the country as a whole experienced a recessionary period in the 1980's, the sound strategy of the ESPP's investment managers produced unprecedented growth in the assets available to satisfy the plan's obligations. The ESPP's net assets mushroomed from $494,321,407 in 1983, to over one billion dollars, $1,034,422,135, at the start of the plan year 1994.

On March 26, 1990, when the ESPP had a surplus[2] of more than $400,000,000, Conrail amended the ESPP to provide early retirement incentives for some of the plan participants through the creation of a Special Voluntary Pension ("SVP"). The alleged cost of the SVP — approximately $100,000,000 — was purportedly paid from the ESPP surplus. On November 9, 1991, when the ESPP had a surplus in excess of $390,000,000, the ESPP was further amended, pursuant to section 420 of the Internal Revenue Code, 26 U.S.C. § 420, and ERISA, to provide health care benefits for plan participants through the creation of the Health Benefits Account. The cost of the Health Benefits Account was allegedly paid from the ESPP surplus.

According to petitioners, in 1994, the plan surplus was approximately $538,162,706. Neither amendment to the plan affected the bargained-for agreement by which Conrail remained

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(Cont'd)
assets impair the plan's ability to make the scheduled payments from the plan assets, the employer must make up any deficiency from its own assets. In addition, if the investment of plan assets is successful and produces a surplus, the employer benefits. *Brillinger v. General Electric Co.*, 130 F.3d 61, 62 (2d Cir. 1997) (citing *Malia v. General Electric Co.*, 23 F.2d 828, 830 n.2 (3d Cir. 1994)).

2. Surplus is the assets above those needed to satisfy the plan's actuarially-determined obligations to participants. *Malia*, 23 F.3d at 830.

obligated to pay benefits, and petitioners' accrued benefits under the ESPP were not in any manner reduced. Simply stated, petitioners are receiving all of the benefits promised to them, and the remaining surplus provides a substantial funding cushion to insure the payment of these benefits.

REASONS FOR DENYING THE WRIT

The lower courts correctly resolved the issues before them and, as such, there is no special or important reason for granting review of this matter. Defined benefit pension plan participants, like these petitioners, have no present interest in the assets securing their pensions, and enjoy only a contractual right to a stream of benefit payments. *Johnson v. Georgia-Pacific Corp.*, 19 F.3d 1184, 1186 (7th Cir. 1994). Because petitioners cannot show that Conrail's plan amendments impaired their right to benefits, the lower courts properly dismissed their surplus claims. In addition, the amendments to the ESPP providing for the additional benefits do not constitute fiduciary activity and, thus, are immune from scrutiny under ERISA.

This case does not present a conflict among the circuit courts or present an important federal question. Petitioners' suggest, without legal or factual support, that the Third Circuit's judgment order affirming the district court's dismissal at the pleading stage conflicts with the Ninth Circuit's decision in *Jacobson v. Hughes Aircraft Co.*, 105 F.3d 1288 (9th Cir. 1997). None of the facts critical to the Ninth Circuit's decision is present here; hence, the conflict petitioners suggest is imagined, not real.

I.

THE COURT BELOW FULLY CONSIDERED AND CORRECTLY DECIDED THE ISSUES.

Petitioners claim that Conrail's amendments to the ESPP, to increase participants' benefits through the creation of the SVP and the Health Benefits Account, violate ERISA's fiduciary standards. They predicate their arguments on a claim that these amendments utilized a portion of the ESPP's surplus assets, although hundreds of millions of dollars remain to satisfy their future benefits. The lower courts properly concluded that Conrail's amendments to the ESPP relate solely to Conrail's role as "settlor" of the ESPP, not as a "fiduciary", and thus fall outside ERISA's fiduciary duty standards. Moreover, defined benefit plan surplus is not a tangible *res* to which plan participants may properly make claim, and the employer's use of these monies is one of the incidental benefits of defined benefit plan sponsorship recognized by this Court.

ERISA does not require employers, such as Conrail, to establish benefits plans or to grant employees any particular level of benefits. *Spink v. Lockheed Corporation*, 116 S. Ct. 1783, 1788 (1996) (hereinafter "*Lockheed I*"). ERISA permits an employer to fulfill two roles — that of an administrator (subject to fiduciary duties) and that of a settlor or plan designer (not subject to fiduciary duties). *Varity Corp. v. Howe*, 116 S. Ct. 1065, 1071 (1996) (quoting 29 U.S.C. § 1002(21)(a)). Simply put, settlor functions do not implicate fiduciary duties or standards.

This Court's decision in *Lockheed I* disposes of the arguments advanced in the petition. Specifically, *Lockheed I* makes clear that the challenged amendments do not constitute fiduciary activity, and, as such, are not subject to ERISA. As this Court held:

> "only when fulfilling certain defined functions, including the exercise of discretionary authority or control over plan management or administration" does a person become a fiduciary under [ERISA] § 3(21)(a).

116 S. Ct. at 1789 (quoting *Siskind v. Sperry Retirement Program, Unisys*, 47 F.3d 498, 505 (2d Cir. 1995)). In *Lockheed I*, the Court found:

> "[b]ecause [the] defined functions [in the definition of fiduciary] do not include plan design, an employer may decide to amend an employee benefit plan without being subject to fiduciary review."

116 S. Ct. at 1789 (quoting *Siskind*, 47 F.3d at 505). Accordingly, plan design and amendment, such as that challenged here, do not trigger ERISA's fiduciary standards.

Indeed, Congress precisely legislated both the allocation and the circumstances and timing of the distribution of the surplus held by a defined benefit plan.[3] ERISA provides that petitioners

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3. The Seventh Circuit's decision in *Georgia-Pacific*, described the nature of the employer's promise of benefits to participants, and the severe limitations on participants' rights to the underlying trust assets:

> [T]he retirees do not own the assets of a defined-benefit pension plan. Their contributions purchased not a pool of assets (as would be the case with a defined-contribution plan) but a promise of benefits. *Employees who contribute to a defined-benefit plan are in this respect like persons who purchase annuity contracts from insurance companies.* They obtain a guaranteed stream of payments; the insurer (or, with pension plans, the employer) bears the investment risk.

Georgia-Pacific, 19 F.3d at 1186 (emphasis added) (citations omitted).

may be entitled to a portion of the surplus ESPP assets only upon termination of the plan and, until then, they have no legally cognizable interest in that surplus.[4] Moreover, the use of the term "surplus" is something of a misnomer:

> Consider what the "surplus" of a defined-benefit plan is. It is not a pile of assets stacked in the corner. It is instead an accounting construct. The plan determines the value of its assets — stocks, bonds, real property, cash, and so on. It also estimates the cost of fulfilling all of the promises to pay vested benefits. The former computation yields the asset side of the balance sheet, the latter computation the liability side. The difference between these is the "surplus" or "deficit" . . . .

Georgia-Pacific, 19 F.3d at 1189.

Further, petitioners' conclusory allegation that Conrail received some benefit by amending the ESPP does not alter the conclusion that Conrail's decision to amend the ESPP falls outside the boundaries of ERISA's fiduciary standards. In *Lockheed I*, the Court explained that the receipt of a benefit by the employer redesigning or amending a pension plan is permissible under ERISA:

> [A]mong the "incidental" and thus legitimate benefits that a plan sponsor may receive from the operation of a pension plan are attracting and retaining employees, paying deferred compensation, settling or avoiding strikes, providing increased compensation without increasing wages, increasing employee turnover, and reducing the likelihood of

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4. *See Malia*, 23 F.3d at 832 ; *Georgia-Pacific*, 19 F.3d at 1189.

> lawsuits by encouraging employees who would otherwise have been laid off to depart voluntarily. . . .

Lockheed I, 116 S. Ct. at 1791 (citing Brief of Respondent Spink at 11). Any incidental gain arguably received by Conrail as a result of the creation of the SVP and the Health Benefits Account falls squarely within these enumerated, permissible benefits. For example, Conrail's decision to enhance the benefits of those participants who chose early retirement through the SVP merely "increas[ed] employee turnover" and "encourag[ed] employees who would have been laid off to depart voluntarily."

In addition, Conrail's 1991 decision to amend the ESPP to fund its Health Benefits Account was explicitly authorized by the 1990 amendments to the Internal Revenue Code and ERISA, specifically allowing plan sponsors to fund retiree medical plans from pension plan surplus. Indeed, Conrail relied upon section 420 of the Internal Revenue Code, "Transfers of Excess Pension Assets to Retiree Health Accounts," 26 U.S.C. § 420, to create the Health Benefits Account.

ERISA section 404(a) similarly excludes such transfers from scrutiny:

> Subject to sections 403(c) and (d), 4042 and 4044 of this title, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries. . . .

29 U.S.C. § 1104(a). Section 403(c)(1) provides, in turn, that the assets of a plan shall never inure to the benefit of any employer *"except as provided . . . under section 420 of the*

Internal Revenue Code of 1986 (as in effect on January 1, 1991."[5] 29 U.S.C. § 1103(c)(1) (emphasis added).

ERISA's "exclusive benefit rule," section 404(a)(1), 29 U.S.C. § 1104(a)(1), is equally inapplicable to petitioners' claims. As one court observed, "under a clear reading of the statute, section 420 transfers are exempt from the prudent man standard of 29 U.S.C. § 1104." *Chemtech Indus. v. Goldman Financial Group, Inc.*, 809 F. Supp. 729, 733 (E.D. Mo. 1992). ERISA section 404 expressly incorporates section 403, including its Internal Revenue Code section 420 exemption. Further, Conrail established the Health Benefits Account to assist the same employees who participated in the ESPP; thus, the benefit of the surplus flowed to the "participants," as required under ERISA section 404.

Despite petitioners' protestations to the contrary, the amendments made by Conrail, providing participants additional benefits, do not raise issues involving fiduciary conduct and, as such, may not be challenged under ERISA. Petitioners' claimed, but unsubstantiated and unwarranted, fear of some unspecified future harm does not alter this reality. Accordingly, the lower courts properly considered and rejected petitioners' claims.

II.

THE ALLEGEDLY CONFLICTING DECISION BY THE NINTH CIRCUIT IS READILY DISTINGUISHABLE.

The petition seeks to obfuscate the record below in an ill-fated attempt to create the illusion of similarity between *Jacobson* and this dispute. Because the facts before the Ninth Circuit were

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5. In addition, under ERISA section 408(b), transfers permitted by section 420 of Title 26 are exempt from ERISA's "prohibited transaction" provisions of section 406. 29 U.S.C. §§ 1106, 1108(b)(13) (1992).

significantly different from those here, any suggestion that a conflict exists between the Ninth Circuit and the Third Circuit based on its summary affirmance of the district court's dismissal of petitioners' claims, is erroneous.

In *Jacobson*, the Ninth Circuit reversed the dismissal of a complaint alleging that Hughes Aircraft Company ("Hughes") violated its fiduciary duties under ERISA section 404(a), 29 U.S.C. § 1104, and the anti-inurement provisions of ERISA section 403(c)(1), 29 U.S.C. § 1103, when Hughes amended its contributory defined benefit plan to freeze enrollment in the contributory portion of the plan and then established a non-contributory benefit formula for new employees. 105 F.3d at 1290-91. The complaint further alleged that the amendment at issue caused the termination of the plan and, in turn, the establishment of a new plan. In addition, the complaint asserted that use of the surplus assets allegedly attributable to employee contributions to fund benefits under the non-contributory plan improperly benefited Hughes, and reduced the plaintiffs' accrued benefits. *Id.*

Certain facts were critical to the Ninth Circuit's determination that the defendant was acting as a fiduciary at the time it amended the pension plan and was, therefore, subject to ERISA's fiduciary standards. The Ninth Circuit relied on the following: (1) Hughes purportedly terminated the pension plan; (2) the new plan was created for the benefit of employees who had not participated in the original plan; and (3) plaintiffs' accrued benefits were diminished as a result of Hughes' use of surplus assets.[6] *Id.* at 1295-96. None of these facts is present here.

First and foremost, plaintiffs claimed that the plan was

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6. The Ninth Circuit in *Jacobson* sought to distinguish its decision from this Court's opinion in *Lockheed I* on two additional grounds: (1) this Court did not address whether Lockheed violated ERISA's anti-inurement provision; and (2) the fund at issue in *Lockheed I* was non-contributory. *Jacobson*, 105 F.3d at 1293.

terminated when Hughes froze new enrollment and established a new plan. *Jacobson*, 105 F.3d at 1293. Such a termination, plaintiffs maintained, triggered their rights under ERISA section 4044, 29 U.S.C. § 1344.[7] Here, however, petitioners admit that there has been no termination of the ESPP, triggering ERISA section 4044. In their brief to the district court, dated April 28, 1993, petitioners conceded that no such termination occurred:

> At present, the plaintiffs are not suggesting that the ESPP, or any portion thereof, be terminated.
>
> * * *
>
> It simply is beyond question that the members of the Engelhart class would have rights in the plan surplus *if the ESPP were to terminate*.

Given the Ninth Circuit's significant reliance on the plaintiffs' allegation of plan termination and the absence of such an averment here, a conflict between the Ninth Circuit and the Third Circuit is absent.

A second critical distinction between petitioners' claims and those before the Ninth Circuit in *Jacobson* is the fact that, after terminating the original plan, surplus assets of that plan were used by Hughes to establish a new plan covering individuals who had not been participants in the original plan. Through the challenged amendment to the ESPP to provide for the enhanced early retirement program and the Health Benefits Account, Conrail extended additional benefits only to existing ESPP participants, and not to anyone who was not already a

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7. As noted above, ERISA section 4044, 29 U.S.C. § 1344, describes the allocation of assets upon termination of a defined benefit pension.

plan participant. *See* ESPP at 3-4. Thus, Conrail simply redesigned the ESPP to fund additional benefits to certain participants (without reducing the level of benefits of the remaining participants).

The Ninth Circuit's later opinion in *Spink v. Lockheed Corporation*, 125 F.3d 1257, 1260-61 (9th Cir. 1997) (hereinafter "*Lockheed II*"), demonstrates that the fundamental premise of *Jacobson* rested on the fact that the plan sponsor's largess was showered upon individuals who were *not* participants in the original, pre-amendment plan. Following this Court's remand of *Lockheed I*, the district court granted the defendant's motion to dismiss and the plaintiff appealed. On appeal, the Ninth Circuit specifically addressed ERISA section 403(c)(1), 29 U.S.C. § 1103(c)(1), and relying, in part, upon this Court's decision in *Lockheed I*, concluded that an employer's use of plan assets to purchase waivers for its own liability was permissible under ERISA's anti-inurement provision. 125 F.3d at 1260. More specifically, in *Lockheed II*, the Ninth Circuit relied upon and noted favorably the decisions of other circuits:

> that have held that an employer does not receive "inurement" under § 403 where plan assets were paid *only to plan participants and the plan only advances the employer's business interests.*

125 F.3d at 1261 (emphasis added) (citing cases). Accordingly, based upon the reasoning of the Ninth Circuit in *Lockheed II*, it would appear that the Ninth Circuit would reach the same conclusion that the Third Circuit reached here.

Moreover, the employee contributions to the ESPP are, at best, *de minimis*, particularly when compared to the amount of

surplus in the ESPP.[8] The plan at issue in *Jacobson*, on the other hand, was funded *equally* by employer and employee contributions. 105 F.3d at 1291. Further, and quite unlike the facts in *Jacobson*, these petitioners always enjoyed the right to withdraw their contributions before retirement. Central to the Ninth Circuit's ruling in *Jacobson* was the plaintiffs' specific allegation that when Hughes used the surplus, it reduced their accrued benefits. *See* 105 F.3d at 1293. Here, however, petitioners never alleged, because they could not, that the creation of the SVP and the retiree Health Benefit Account reduced or otherwise affected petitioners' accrued benefits. Simply stated, notwithstanding the amendments to the ESPP, petitioners continue to receive *all* of the benefits owing under the terms of the plan.

In light of the clear emphasis placed by the Ninth Circuit on the fact that Hughes had terminated its pension plan, that outsiders to the plan were benefited by Hughes' use of plan surplus, and that the plaintiffs in *Jacobson* claimed that their actual benefits had been reduced as a result of the creation of the new plan, the unique and readily distinguishable factual

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8. As recited in the complaint, employee contributions comprised an insignificant portion of the ESPP's assets:

PLAN YEAR	EMPLOYEE CONTRIBUTIONS
1982	$ 15,949.00
1983	$ 136,196.00
1984	$ 83,403.00
1985	$ 195,725.00
1986	$ 86,092.00
1987	$ 284,994.00
1988	$ 73,411.00
1989	$ 65,753.00
1990	$ 38,328.00

basis for that decision does not support petitioners' claim here of a conflict among the circuits. The ESPP was merely amended, not terminated, to provide supplemental benefits to certain of the plan's participants. In light of these matters and the uncontroverted and continued robust financial condition of the ESPP, it is evident that no harm has befallen petitioners requiring this Court's intervention or review.

CONCLUSION

Petitioners' claims were properly rejected as falling outside ERISA and the decisional conflict they describe is illusory, when considered in light of the framework of that statute, case law and factual setting. The petition should be denied.

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No. 97-885

In The

Supreme Court of the United States

October Term, 1997

PAUL J. ENGELHART, *et al.*,

Petitioners,

vs.

CONSOLIDATED RAIL CORPORATION, *et al.*,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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I. THE RESPONDENTS' RELIANCE UPON *SPINK v. LOCKHEED CORPORATION* IS MISPLACED.

The respondents contend that this Court's decision in *Spink v. Lockheed Corporation*, 116 S. Ct. 1783 (1996) (hereinafter *Lockheed I*) "disposes of the arguments advanced in the petition" because the amendments creating the SVP and retiree health care benefits did not implicate the fiduciary duty provisions of ERISA. *See* Respondents' Brief in Opposition, pages 4 and 5. This argument is flawed in two respects.

First, the respondents fail to address whether there is a fundamental difference between overfunded contributory and non-contributory pension plans. In an overfunded contributory plan the surplus is attributable to both employer and employee contributions, while a non-contributory plan surplus is funded entirely by employer contributions. The petitioners do not contend that the participants in a non-contributory plan have an interest in the surplus because the participants have, by definition, not contributed to the existence of that surplus. As the Ninth Circuit stated in *Jacobson v. Hughes Aircraft*, 105 F.3d 1288, 1296 (1997):

> In essence, when a plan is funded by both employer and employee contributions, both the employer and the employees are co-settlors of the plan.

This is the basic premise on which this case turns. A discussion of when fiduciary duties attach under ERISA without first addressing this issue is futile.

Secondly, *Lockheed I* is readily distinguishable from this case because the *Lockheed* plan was a non-contributory pension plan, and this Court did not address whether the *Lockheed* early retirement program violated ERISA's anti-inurement provision as applied in that plan context. The Ninth Circuit distinguished *Jacobson* and *Lockheed I* on this basis. *See* 105 F.3d at 1293.

II. THE RESPONDENTS HAVE FAILED TO DISTINGUISH THIS CASE FROM THE DECISION OF THE NINTH CIRCUIT IN *JACOBSON v. HUGHES AIRCRAFT COMPANY.*

According to the respondents, this case is factually distinguishable from the decision in *Jacobson. See* Respondents' Brief in Opposition, pages 8-13. Their attempts to distinguish these cases must fail because the respondents either have misread *Jacobson* or misapprehend the facts of this case.

A. The Ninth Circuit's Holding In Jacobson Does Not Depend Upon The Occurrence Of A Plan Termination.

The respondent assert that the plaintiffs' rights in *Jacobson* under ERISA section 4044, 29 U.S.C. § 1344 were "triggered" by the termination of the *Hughes* Non-Bargaining Retirement Plan, and that the Ninth Circuit's reversal of a Rule 12(B)(6) dismissal turned upon the allegation that such a termination had occurred. See Respondents' Brief in Opposition at page 10. According to the respondents, the absence of a termination of the Supplemental Plan distinguishes the present case from *Jacobson*. However, the respondents have read the *Jacobson* holding too narrowly and have overlooked the Ninth Circuit's statement in footnote 4, 105 F.3d at 1295:

> n4 Even if we were to conclude as a matter of law that no termination has occurred here, we find that plaintiffs could still amend their complaint to allege a different theory of recovery. As the Seventh Circuit recently noted in a case involving an employer's decision to amend a pension plan to use surplus assets to increase the benefits of current employee participants without increasing the pension benefits of retired participants:
>
> A transaction of this kind would reduce the expected value of the benefits. Writing additional promises

> without increasing the assets available to fund those promises increases the risk that at some time in the future — if, perhaps the economy takes a downturn and . . . [the employer] is unable to top up the plan — the trust will be unable to satisfy all of its obligations . . . . [thus] increasing the risk of nonpayment.
>
> *Johnson v. Georgia-Pacific Corp.*, 19 F.3d 1184, 1187 (7th Cir. 1994). The Supreme Court in *Lockheed* also recognized that "commercial bargains that present a special risk of plan underfunding" are the kind of transactions that ERISA was intended to prohibit. 116 S. Ct. at 1971.

Clearly, the Ninth Circuit did not hold, as the respondents contend, that the allegation or occurrence of a plan termination was a sine qua non to the claims advanced by the petitioners. Instead, the court explicitly stated that contributory plan participants such as the petitioners can challenge plan amendments creating new categories of benefits payable in part from the employee-generated portion of a plan surplus as an impairment of the financial security of the fund from which their benefits are paid. The petitioners specifically alleged this very theory in their complaint. C.A. App. A593, A595, A601.[1] The respondents have simply ignored this aspect of the Ninth Circuit's decision in *Jacobson.*

B. Conrail Has Funded The SVP Benefits And Retiree Health Care Accounts From The Supplemental Plan Surplus For Participants Who Never Contributed To The Existence Of That Surplus.

In *Jacobson* surplus assets of the contributory *Hughes Aircraft* plan to fund a new non-contributory pension plan and a special early retirement plan. *See* 105 F.3d at 1293. In their complaint the

1. We again refer to the appendix below in *Engelhart v. Consolidated Rail Corporation*, No. 96-1920.

Jacobson plaintiffs had alleged "that is so doing, *Hughes* is improperly using plan assets attributable in part to employee contributions for its own benefit." *See* 105 F.3d at 1291. The petitioners have made the same allegations in their complaint. C.A. App. A592-A595, A600. The participants in the *Hughes* non-contributory plan and the early retirement program had never been participants in the contributory plan and therefore had never contributed to the existence of the surplus in that plan. The respondents predictably contend that the amendments funding the SVP and retiree health care accounts were designed to provide additional benefits for Conrail management employees who were already Supplemental Plan participants. This is a superficial distinction which does not withstand a closer historical scrutiny of the Supplemental Plan and its predecessor plans.

Non-agreement, *i.e.* management, Conrail employees have never made contributions to the Supplemental Plan at any time during its existence, nor were any made to the Penn Central Plan during its relatively brief existence.[2] Until February 1, 1965 the Pennsylvania Railroad and its non-agreement employees made matching contributions to the PRR Plan.[3] On February 1, 1965 the PRR notified management employees that their participant contributions were no longer needed to fund the PRR Plan. C.A. App. A587. Most of the Merged Plans also required matching contributions from non-agreement personnel as a precondition to matching contributions from the Merged Railroads. C.A. App. A587. In short, the petitioners represent a large group of former railroad employees who made matching employee contributions to their pension plans during their lengthy railroad careers.[4] Those

2. The Penn Central Plan, like the Supplemental Plan, required contributions from agreement personnel.

3. The PRR Plan had required matching employer and management employee contributions since it was established on June 1, 1938.

4. Rather than examine the history of employee contributions to (Cont'd)

Conrail management employees who participated in the SVP or were provided benefits from the retiree health care accounts have never contributed to the existence of the Supplemental Plan surplus. The petitioners do not begrudge the good fortune of those Conrail employees selected to participate in the SVP and the retiree health care accounts as long as those benefits are funded solely from that portion of the surplus attributable to employer contributions. The petitioners merely contend that Conrail does not have unfettered discretion to use that part of the Supplemental Plan surplus attributable to employee contributions to fund these new benefit categories. This is the fundamental concept upon which the Ninth Circuit concluded that the *Jacobson* plaintiffs had stated viable causes of action under 29 U.S.C. §§ 1103(c)(1) and 1104(a)(1). *See* 105 F.3d at 1294 and 1296.[5]

CONCLUSION

The respondents' attempts to distinguish the Ninth Circuit's holding in *Jacobson* from the decision of the Third Circuit in this case and their reliance on this Court's holding in *Lockheed I* fail. This case presents an issue of global significance under ERISA. Therefore, the petition should be granted.

(Cont'd)

all the relevant plans, the respondents discuss only a nine year period during which only agreement employee contributions were made and after two years of which Conrail's employer contributions ceased.

5. The relevant holdings appear at pages 19 and 21 of the Petition for Writ of Certiorari.

Respectfully submitted,

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